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IN THE

Supreme Court of the United States

OCTOBER TERM, 1961.

No. 186

BANKERS LIFE AND CASUALTY COMPANY,
Petitioner,

vs.

BELLANCA CORPORATION,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF FOR THE RESPONDENT IN OPPOSITION.

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THE GUNTHROP-WARREN PRINTING COMPANY, CHICAGO

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QUESTIONS PRESENTED.

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1. Where 500,000 shares of stock owned by the seller are sold and immediately delivered to the purchaser, and where the purchaser expressly elects to keep the stock after having an opportunity to return it, does the enforcement of a quasi-contractual obligation to pay reasonable value for the shares offend any provision of the Securities Exchange Act of 1934?

2. Was the contract of May 8, 1956 made, or performed, in violation of Section 16(c) of the Securities Exchange Act of 1934?

STATEMENT OF THE CASE.

In this action Bellanca seeks payment for 500,000 shares of stock which it sold and delivered to Bankers Life on May 8, 1956, and for which it has been paid nothing. Having made an election to retain the stock, the purchaser resists payment on the ground that the contract of sale was invalid under the Securities Exchange Act of 1934.

The District Court found no violation of the Act. It entered judgment for the reasonable value of the stock, rather than the contract price, since Bellanca had not performed the contract in full.

The Court of Appeals affirmed, also holding as a matter of state law that Bellanca could not recover at the contract rate. It assumed *arguendo* that the contract was void, and held that neither this assumption nor the default under the contract would preclude a recovery of reasonable value.

The essential facts are set forth in the findings of the District Court (App. 493-8).

On May 8, 1956, the parties entered into a written contract providing for the sale by Bellanca to Bankers Life of 1,112,500 shares of the common stock of Automatic Washer Company at a price of $8.00 per share (Fdg. 4, App. 494).[1] The contract provided for the immediate delivery of 500,000 shares, and delivery of the additional 612,500 shares within 90 days (Fdg. 6, App. 494). As provided, 500,000 shares were delivered upon execution of the contract, but

1. The entire contract, Bellanca Exhibit 2, is printed at App. 469-479. There was also a separate paragraph in the contract enabling Bankers Life to acquire additional shares from Automatic Washer at a price of $6.75 per share, if such additional shares were needed to give it 51% ownership of the company at the closing (App. 471). When the contract was signed, 1,112,500 shares represented more than 50% of the outstanding stock (App. 265).

the additional shares were not delivered (Fdg. 7, App. 494).

Exactly 90 days after the execution of the agreement, Bankers Life made a written election to terminate the contract and to retain the 500,000 shares which had been delivered (Fdg. 8, App. 494).

At all times since delivery of the 500,000 shares, Bankers Life has retained the stock (Fdg. 13, App. 495). At the trial, it offered no evidence to justify or excuse its retention of the stock without paying for it (Fdg. 20, App. 496-7). Record ownership of the shares was transferred from Bellanca to Bankers Life promptly after delivery and the change of ownership was reported to the Securities Exchange Commission and the Midwest Stock Exchange (App. 277, 273-4, 466, Bellanca Exhibit 1).

The 1,112,500 shares covered by the contract included 900,000 shares owned by Bellanca and 212,500 owned by the president of the corporation (Fdgs. 19, 9-12, App. 495-6). The president authorized Bellanca to enter into the contract to sell his shares, as well as Bellanca's, and without his authorization Bellanca would not have entered into the contract (Fdg. 19, App. 496). The purchaser was advised that part of the stock covered by the agreement was owned by the president of the company (Fdg. 17, App. 496). The contract did not require or contemplate any transactions on the Stock Exchange, and in fact, none occurred (App. 501).

When the contract was executed, the parties contemplated a final closing within less than 20 days (Fdg. 15, App. 496). Some delay was required to accommodate the purchaser, who had to make certain arrangements to pay the purchase price specified in the contract (Fdg. 16, App. 496). Nevertheless, it never did make any payment, or tender, of the price or any part thereof (Fdg. 20, App. 496-7, 315).

ARGUMENT.

I. The Implied Contract to Pay for the 500,000 Shares Was Perfectly Lawful and Petitioner Does Not Contend Otherwise. Accordingly, the Entire Petition for Certiorari Is Beside the Point.

The question discussed in the Petition for Certiorari is purely hypothetical since the record discloses no violation of Section 16(c) of the Securities Exchange Act of 1934. Nevertheless, the short answer to the petition is that given by the Court of Appeals.

As a matter of state law, when Bankers Life terminated the original contract and made its election to retain the 500,000 shares, a separate new obligation relating only to those shares was created. As a consequence of the election, an implied contract to pay for the 500,000 shares arose. *Richards* v. *Shaw*, 627 Ill. 222, 224 (1873); *United States* v. *Molloy*, 144 Fed. 321, 324 (C. A. 2, 1906); *Williston on Contracts* (2d Ed. 1937), Vol. 5, § 1474, pp. 4121-4123.

Even if we assume for the sake of argument that the original written contract was illegal and therefore void, the question is whether federal law precludes a recovery of the reasonable value of the 500,000 shares. These shares were owned by Bellanca at the time of transfer, and were immediately delivered to the purchaser. Petitioner does not even argue that the implied contract to pay for those shares violated the law in any way. Petitioner's attack on the transaction relates entirely to the undelivered 612,500 shares.

No doubt it would be improper to deny recovery on an illegal written contract and then to permit recovery on an implied contract that was also illegal. But such is not the

case here. There is nothing about the implied contract to pay for the 500,000 shares that even remotely offends the language or the policy of the Securities Act. Accordingly, there should be no question about Bellanca's right to be paid for its property.

II. There Is No Violation of Section 16(c) of the Securities Exchange Act of 1934.

Section 16(c) prohibits two types of transactions by insiders. Clause (1) prohibits a sale of more shares than are owned by the seller or his principal (i.e., a "short sale"). Clause (2) requires an insider to deliver his own shares against a sale within twenty days after the sale is consummated (i.e., to repay the loan of shares made to consummate a "sale against the box" within twenty days thereafter). See Loss, *Securities Regulation* (1951), 581.

The undisputed evidence showed that Bellanca owned the 500,000 shares at the time of their delivery to petitioner, and also that Bellanca or its principal owned more than the 1,112,500 shares covered by the contract (Fdgs. 9, 10, 12, 17, 18 and 19; App. 495-6). Thus, the issue of fact arising under the first clause of Section 16(c) was resolved against petitioner in the trial court's findings.

Clause (2) of Section 16(c) is inapplicable because Bellanca did not consummate the sale by making delivery to petitioner with borrowed shares. There was no occasion to cover a sale within the twenty day period after delivery to the purchaser.

There is no basis for petitioner's contention that the contract of May 8, 1956 contravenes Section 16(c).

III. Section 29(b) of the Securities Exchange Act of 1934 Does Not Apply to the Contract of May 8, 1956.

Section 29(b) applies only to contracts which are *made* in violation of the Act, or *performed* in violation of the Act. There was nothing about either the making of the original contract, or its actual performance, which violated the statute.

When the contract was made, Bellanca or its principal owned the shares covered by the contract, and both parties contemplated a complete delivery within less than twenty days (Fdg. 15, App. 496). Delivery after twenty days and before ninety days elapsed was permitted by the contract, but the agreement did not *require* a delay of more than twenty days and no such delay was intended. Therefore, at the time the contract was executed, it was lawful in all respects. It was not "made in violation of any provision of [the Act]".

The only performance of the contract was the immediate delivery of 500,000 shares which Bellanca owned. This performance did not "involve the violation" of any provision of the Act, and there was no further performance. Since neither the making nor the actual performance of the contract involved any violation of the statute, Section 29(b) has no application to the transaction.

Even if it be assumed that Section 29(b) is applicable, the statute does not render the contract totally and absolutely void. Nor does it void all rights arising out of the transaction, as petitioner seems to assume. The prohibited contracts are "void" only as to certain rights, only as to certain persons, and only for a limited period of time. The statute does not affect the purchaser's right to treat the contract as valid if it so elects. Thus, under the interpretation of the Securities Exchange Act most favorable

to it, petitioner, on August 8, 1956, had an option either to treat the contract as valid or to treat it as void.

Petitioner did not elect to rescind or to avoid the agreement. On the contrary, it expressly elected to terminate the contract and to create a separate obligation to pay for the retained shares. Petitioner does not even argue that the sale of the 500,000 shares, considered separately, involved any violation of the law.

IV. There Is No Conflict.

The two federal cases cited by petitioner do not support its reading of the Securities Exchange Act of 1934. *Goldenberg* v. *Bache & Company*, 270 F. 2d 675 (C. A. 5, 1959), involved a broker's violation of stock exchange regulations governing trading on margin. The violation resulted from an accounting error, in which the calculation of the value of a customer's account was computed on the basis of a stock named "Electronics", when the stock actually on deposit with the broker was "Eltronics". Neither the broker nor the customer discovered the mistake until after the period of limitation prescribed in Section 29(b) of the Securities Exchange Act had expired.[2] Therefore, although both parties contended that they had been injured by the mistake, neither could recover after the statute of limitations had run. Entirely apart from Section 29(b), the court also stated that since the broker had made the mistake, it could not recover any loss which it had caused itself. The decision has no relevance to the issue before this Court. The court did not suggest, and

2. The portion of Section 29(b) pertinent to that decision reads as follows:

"• • • no contract shall be deemed to be void by reason of this subsection • • • unless such action is brought within one year after the discovery that such sale or purchase involved such violation and within three years after such violation." See 270 F. 2d at 677, Note 2.

nothing in the opinion remotely implies, that the customer could have acquired securities from her broker and retained them without paying for them.

Petitioner also relies heavily on *Kaiser-Frazer Corp.* v. *Otis & Co.*, 195 F. 2d 838 (C. A. 2, 1952). In that case the court held that the defendant, an underwriter, was not liable in an action for damages for breach of an executory contract. The defendant refused to perform its contract to purchase Kaiser securities and resell them to the public, on the ground that Kaiser's prospectus misrepresented its earnings. Kaiser argued that the defendant had knowledge of its actual earnings, and therefore was estopped to defend its refusal to perform on that ground. Since the performance of the contract would have involved a misrepresentation to the public and, therefore, a violation of the Securities Act of 1933, the court held that the contract was unenforceable, regardless of whether or not the underwriter was itself misled. There is not a word in the opinion that suggests that the underwriter could have accepted delivery of Kaiser securities, and then retained them without paying for them. Yet that is the conduct which petitioner asks this Court to sanction in this case.

CONCLUSION.

Petitioner has never indicated how the public interest would be advanced by permitting it to pocket 500,000 shares of stock free of charge. The judgment of the Court of Appeals does not enforce any conduct made unlawful by the Securities Act. Accordingly, this Court's comment in *Kelly* v. *Kosuga* is pertinent:

> "* * * Past the point where the judgment of the Court would itself be enforcing the precise conduct made unlawful by the Act, the courts are to be guided by the overriding general policy, as Mr. Justice Holmes put it, 'of preventing people from getting other people's property for nothing when they purport to be buying it.' *Continental Wall Paper Co.* v. *Louis Voight & Sons Co., supra* (212 U. S. at 271) (dissenting opinion)." 358 U. S. at 520-521.

It is respectfully submitted that the petition for certiorari be denied.

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REPLY BRIEF IN SUPPORT OF PETITION FOR CERTIORARI.

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ARGUMENT.

I.

Federal Policy Cannot Be Avoided by Reference to Irrelevant Decisions Enunciating State Law.

Respondent has attempted to foist on this Court, as it succeeded in doing in the Court of Appeals, an argument that the retention of the shares delivered pursuant to the illegal contract resulted in a quasi-contractual obligation being created.

The argument is specious in the extreme. The retention of the shares by petitioner is expressly stated by respond-

ent to result in an implied contract to pay. The initial paragraph of Section 29 of the Securities Exchange Act of 1934 (§ 78cc(a) Title 15 U. S. C. A.) specifies:

> "Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void."

Petitioner could not therefore explicitly agree to waive a violation. It would be bitter doctrine indeed if, by its conduct, it could be held to have created an implied contract or to have incurred a quasi-contractual obligation more onerous than that rendered void by the Act.

Secondly, the cases from Illinois cited for the proposition that an obligation to pay for the shares received by petitioner are beside the point for two reasons. As pointed out in the reasons granting the writ, the decisions of this Court (*Sola Electric Co.* v. *Jefferson Electric Co.*, 317 A. 173, 176-177, 63 S. Ct. 172, 173-174, 87 L. Ed. 1188, and *Kelly* v. *Kosuga*, 358 U. S. 516, 519) plainly state that the effect of illegality under federal statutes is a matter of national rather than parochial law. Illinois precedents in the face of this principle, undisputed by respondent, simply have no application.

Further, not a single one of the authorities cited by respondent as "state law" is concerned with the defense of illegality. *Richards* v. *Shaw*, 67 Ill. 222, as well as the other authorities cited, is simply concerned with the obligation to pay for goods received and accepted although the entire quantity contracted for had not been delivered. The question of illegality did not enter into the discussion.

In Illinois, if state law is termed relevant, the rule directly concerned with illegal contracts is stated in 12 Illinois Law & Practice § 194, "Contracts," page 353:

> "Where parties to an illegal contract are *in pari delicto* and the contract has been executed on the part of one of them by a conveyance of property or the payment of money, neither party can recover anything transferred or paid under the contract."

A fortiori, where the guilty party seeks to recover from the innocent second party, no recovery can be had.

II.

The Securities Exchange Act of 1934 and the Contract Between the Parties.

The importance of certiorari in this case is only emphasized by respondent's arguments relative to the existence or non-existence of a violation of the Securities Exchange Act of 1934. In explicit terms, the Court of Appeals "did not deem it necessary" to review the findings of the District Court to determine whether the contract violated the Act. Indeed, the Court added, with reference to the circumstances of this case, "the presence or absence of a § 78p(c) violation is without material legal effect." (Appendix to Petition, p. D-5.)

The cavalier attitude toward the policies embodied in the Act as expressed in the Court of Appeals Opinion, is sufficient cause for the grant of certiorari.

The violation or non-violation not having been decided by the Court of Appeals, any argument directed thereto is beside the point. It is sufficient to note that respondent did not own the total of shares contracted to be sold and did not deliver the shares within the time limits of Section 16(c).

CONCLUSION.

Petitioner in this case is not charged with the duty of explaining "how the public interest would be advanced" by agreement with its position. Congress, in enacting Section 29 of the Act, has formulated its concept of how the public interest is to be protected—with a scope far greater than the immediate interests of either petitioner or respondent.

Insofar as the "public interest" is involved the breadth of the statutory proscription is matched only by the interest of the public that the Courts follow Congressional mandates.

It is respectfully submitted that certiorari be granted in order to insure the public's interest in both the statutory policy and the adherence of the Federal courts thereto.

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